FILE COPY

Office Supreme Court,
FILED
SEP 17 192
CHARLES ELMORE

No. 402

In the Supreme Court of the United States

OCTOBER TERM, 1929

UNITED STATES OF AMERICA, PETITIONER

v.

GUARANTY TRUST COMPANY OF NEW YORK, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

INDEX

	Page
Petition:	
Statement	1
Specification of errors	5
Reasons for granting the writ	5
Brief:	
Opinions below	7
Jurisdiction	7
Question presented	7
The statute	8
Statement	8
Argument	8

CITATIONS

Beaston v. *Farmers' Bank*, 12 Pet. 102	9–10
Bramwell v. *U. S. Fidelity Co.*, 269 U. S. 483	6, 9, 10, 17
Mellon v. *Michigan Trust Company*, 271 U. S. 236	10, 11, 12
St. Louis, I. M. & S. Ry. Co. v. *Taylor*, 210 U. S. 281	17
United States v. *Butterworth-Judson Corporation*, 269 U. S. 504	6, 9, 12, 17
United States v. *Fisher*, 2 Cranch, 358	10
United States v. *Hooe*, 3 Cranch, 73	14
United States v. *State Bank of North Carolina*, 6 Pet. 29	6, 9
R. S. Section 3466 (U. S. C. Title 31, Sec. 191)	8

70589—29——1

In the Supreme Court of the United States

OCTOBER TERM, 1929

No. ——

UNITED STATES OF AMERICA, PETITIONER

v.

GUARANTY TRUST COMPANY OF NEW YORK, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the decree of the Circuit Court of Appeals for the Eighth Circuit entered in the above-entitled cause on May 15, 1929 (R. 118–119) affirming the decree of the District Court of the United States for the District of Minnesota (R. 85).

STATEMENT

The question involved is whether, in the distribution of the assets of an insolvent railroad company in receivership, the United States is entitled under Section 3466 R. S. to priority in payment of debts

due it from that company over other creditors; namely, (1) mortgage trustees, (2) preferred creditors, and (3) general unsecured creditors, or any of them.

The Minneapolis & St. Louis Railroad Company is in the hands of a receiver appointed by the District Court of the United States for the District of Minnesota, July 26, 1923, upon the application contained in a creditor's bill alleging its insolvency. The fact was admitted by the Railroad Company's answer. (R. 1–3.) Subsequently suits were instituted for the foreclosure of mortgages on the property, and were consolidated with the suit begun upon the creditor's bill.

The mortgages in question were made at various dates between 1888 and 1912, which was before the indebtedness to the United States was incurred. (R. 110.) Other claims which the court treated as preferred are those which arose as a current expense of ordinary operation of the Railroad, were necessary for the preservation of the road and the business of the road, were contracted with the expectation and intention of the parties that they were to be paid out of the earnings of the road, and accrued within six months prior to the appointment of the Receiver. (R. 110.)

Prior to the receivership the Railroad Company became indebted to the United States under the provisions of Sections 210, 207 and 209, of the Transportation Act of 1920, in principal amounts aggregating about $3,000,000 under the circumstances set forth in the following paragraphs which

describe the claims by numbers assigned to them in the District Court (R. 5–12) and by which they are identified in the opinion of the Circuit Court of Appeals.

Claim 2700

Item One.—Loan in the principal amount of $1,382,000 from the Secretary of the Treasury to the Minneapolis & St. Louis Railroad Company under Section 210, Transportation Act, 1920, as amended, and Certificate No. 81 of the Interstate Commerce Commission, evidenced by a promissory note executed by the Railroad Company on April 1, 1921, due April 1, 1931, with interest at 6 per cent per annum, payable semiannually.

Item Three.—$625,000 indebtedness of the railroad due to the United States, at the termination of Federal control, funded pursuant to the provisions of Section 207, Transportation Act, 1920, evidenced by the Railroad Company's promissory note acquired by the Director General of Railroads, dated May 27, 1922, due March 1, 1930, with interest at 6 per cent per annum, payable semiannually.

Item Four.—$625,000 representing further indebtedness of the Railroad Company due to the United States at the termination of Federal control, funded pursuant to the provisions of Section 207, Transportation Act, 1920, and evidenced by a promissory note executed by the Railroad Company and acquired by the Director General of Railroads, dated April 2, 1923, due on demand with interest at 6 per cent per annum, payable semiannually.

Claim 4186

> $292,022.23, together with interest thereon at 6 per cent per annum from May 28, 1921, representing an overpayment of advances to the Railroad Company under the guaranty provisions of Section 209, Transportation Act, 1920, that amount having been certified by the Interstate Commerce Commission on April 14, 1924, as paid in excess of the amount guaranteed.

Certain Minneapolis & St. Louis Railroad Refunding and Extension bonds were deposited as collateral for some of this indebtedness. The mortgage under which these bonds were issued was junior to the mortgages under which the mortgage trustees claimed in the instant suit, as to practically all of the property covered by the latter.

The claims of the United States were duly proved to the District Court and were allowed by it with interest to date of the receivership (R. 87–88), except Claim No. 4186, concerning which only the question of priority and not the amount was determined by that court.

The United States claimed priority under Section 3466 R. S. in payment of each of these claims. The District Court, however, allowed three of the claims as general claims only, to be paid pro rata with other claims, "without any preference or priority either against the corpus of the mortgaged property or in relation to any other claim or class

of claims," and held that the fourth claim had "no preferential status." (R. 86–87.) The decree of the District Court was affirmed by the Circuit Court of Appeals for the Eighth Circuit, and it is to review the decree of the Circuit Court of Appeals, entered May 15, 1929, that the writ of certiorari is now sought.

SPECIFICATION OF ERRORS

The Circuit Court of Appeals erred:

I. In holding that Section 3466 R. S. did not apply to claims arising under the transportation Act of 1920.

II. In holding that the claims of the United States are not entitled to priority over the claims of the mortgage trustees.

III. In holding that the claims of the United States are not entitled to priority over the claims of preferred creditors.

IV. In holding that the claims of the United States are not entitled to priority over the claims of general creditors.

REASONS FOR GRANTING THE WRIT

I. This case raises a question which has not heretofore been decided by this Court, namely, whether the priority statute (R. S. Section 3466) applies to claims of the United States arising under the Transportation Act of 1920, and, if so, over what classes of claims such claims of the United States have priority. These are important questions of Federal law. A determination of these questions by

this Court is desirable, not only because of the large amount involved in the instant case, but also because over $50,000,000, owing the United States as a result of transactions pursuant to that Act, may later be involved in similar cases.

II. In so far as the decision of the Circuit Court of Appeals rests upon the theory that the claims arise from the engagement by the United States in a commercial and industrial venture, it is contrary to the decision of this Court in *United States* v. *Butterworth-Judson Corporation,* 269 U. S. 504.

III. The Circuit Court of Appeals has narrowly construed R. S. Section 3466 contrary to the long-established rule that this statute is to be liberally construed in favor of the United States, as laid down by this Court in *United States* v. *State Bank of North Carolina,* 6 Pet. 29, and recently reiterated in *Bramwell* v. *U. S. Fidelity Co.,* 269 U. S. 483, 487.

Wherefore, it is respectfully submitted that this petition should be granted.

CHARLES E. HUGHES, JR.,
Solicitor General.

SEPTEMBER, 1929.

BRIEF IN SUPPORT OF THE PETITION

OPINIONS BELOW

The District Court rendered no opinion, but adopted (R. 88) the memorandum of the Special Master, which is unreported, but appears in the Record at pages 20–82. The opinion of the Circuit Court of Appeals has not yet been reported but is printed in the Record at pages 110–118.

JURISDICTION

The decree of the Circuit Court of Appeals sought to be reversed was entered May 15, 1929. (R. 118.) An order extending the time for filing the petition for the writ to September 17, 1929, was entered by this Court on August 10, 1929. (R. 119.) Jurisdiction to issue the writ is invoked under the provisions of Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, in the distribution of the assets of an insolvent railroad company in receivership, the United States is entitled under R. S. Section 3466 to priority over mortgagees, preferred creditors, and general unsecured creditors, or any of them, in payment of debts due it under the Transportation Act of 1920, Sections 207, 209, and 210.

70589—29——2

THE STATUTE

R. S. Section 3466 (U. S. C. Title 31, Sec. 191):

> Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority hereby established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

STATEMENT

A statement of the facts and an assignment of the errors relied on are set forth in the petition, pp. 1–5, *supra.*

ARGUMENT

I

THE PRIORITY STATUTE, R. S. SECTION 3466, IS APPLICABLE TO THE CLAIMS OF THE UNITED STATES IN THE INSTANT CASE.

The cases in which the priority statute is applicable are enumerated in the latter part of R. S. Section 3466. Here the bill of complaint, praying for appointment of a receiver, alleged the insolvency of the Railroad Company. (R. 1.) The answer admitted its allegations and joined in the prayer that a receiver be appointed to take charge

and possession of its assets. (R. 2.) The assets of the corporation were accordingly turned over to a receiver, and it is now established that the corporation is insolvent within the meaning of R. S. Section 3466 and as defined by the Bankruptcy Act. (R. 18.) As this Court said in *United States* v. *Butterworth-Judson Corporation,* 269 U. S. 504, 513–514:

> Taken in connection with its insolvency, now conceded, respondent's answer admitting the allegations of the complaint and its consent to the decree appointing receivers amounted to the handing over of all its property and business to the receivers to be administered, under the direction of the court, as a trust fund to pay respondent's debts. In substance, the things done by respondent amounted to a voluntary assignment of all its property within the meaning of § 3466.

The Circuit Court of Appeals did not question this point, but in effect held that claims arising under the Transportation Act of 1920 were not "debts due to the United States" within the meaning of the first part of R. S. Section 3466. We submit that in this that court erred. As this Court has said in numerous cases, from 1832 in *United States* v. *State Bank of North Carolina,* 6 Pet. 29, 35, to 1925 in *Bramwell* v. *U. S. Fidelity Company,* 269 U. S. 483, 487, "As this statute has reference to the public good it ought to be liberally construed." In *Beaston* v. *Farmers' Bank,* 12 Pet. 102, 133, 134, the Court laid down the following rule concerning the

construction of the statute which is now Section 3466:

> * * * the person who becomes invested with the title, is thereby made a trustee for the United States, and is bound to pay their debt *first* out of the proceeds of the debtor's property. (Italics ours.)
>
> * * * * *
>
> All debtors to the United States, whatever their character, and by whatever mode bound, may be fairly included within the language used in the fifth section of the act of Congress. And it is manifest, that Congress intended to give priority of payment to the United States over all other creditors, in the cases stated therein. It, therefore, lies upon those who claim exemption from the operation of the statute, to show that they are not within its provisions.

That section extends to debtors generally and is not restricted to any particular class of debts. *Bramwell* v. *U. S. Fidelity Co.,* 269 U. S. 483, 487, *supra; United States* v. *Fisher,* 2 Cranch 358, 397.

The Circuit Court of Appeals, after discussing the Transportation Act of 1920, concluded that it should be accorded the same construction placed upon the Federal Control Act by this Court in *Mellon* v. *Michigan Trust Company,* 271 U. S. 236. But the opinion in that case expressly states at page 239 that "decision of this cause, therefore, must turn upon the effect to be given § 10, Act of 1918," quoted at page 238. That section provides that while under Federal control the carriers shall be

subject to all laws and liabilities to which common carriers are ordinarily subject, except in so far as may be inconsistent with that Act. The Transportation Act contains no such provision. Sections 207 and 210 (under which some of the claims arise) provide, as stated by the Circuit Court of Appeals, that the Government shall take security for loans made and money advanced to railroads pursuant to the provisions of that Act. But this is not inconsistent with the priority granted by Section 3466 because that priority attaches only in the events specified in the latter part of that section. In all other events the Government would have to rely upon an ordinary right of action or upon the security. We submit that the decision in *Mellon* v. *Michigan Trust Company, supra,* resting as it does squarely upon the provisions of Section 10 of the Federal Control Act, affords no support to the Circuit Court of Appeals' construction of the totally dissimilar language of the Transportation Act of 1920.

Moreover, the cash loan (Claim 2700, Item One) and the cash overpayment of the amount guaranteed the Railroad Company during Federal control (Claim 4186) are entirely different in character from the claims asserted in the *Michigan Trust Case,* which were transportation and freight charges accruing to the Director General as the operator of railroads. It must be remembered that these cash loans out of the Treasury of the United States were made long after the termination of Federal control and accrue to the United States—

not to the Director General as the operator of the railroads. They arise because of cash transactions directly between the United States and the Railroad Company and therefore are not to be classed with transportation and freight charges. Although we submit that Items Three and Four of Claim 2700 are also distinguishable from the type of indebtedness involved in the *Michigan Trust Case,* the distinction between these two debts and those involved in that case is not as broad as is the distinction between the loans and the freight charges, for although these items include expenditures by the United States as additions and betterments made to the carrier's property, they also include a variety of general accounts due the Government after final settlements were reached, the balance being funded pursuant to Section 207 of the Transportation Act by the execution of notes by the Railroad Company to the Director General.

The Circuit Court of Appeals concludes that the conditions surrounding the transactions in question differ in no substantial respect from those between private parties, and should be governed by no other rules. That the priority granted by Section 3466 may not be denied merely because the transaction giving rise to the debt has the appearance of a commercial transaction, is clear from the decision of this Court in *United States* v. *Butterworth-Judson Corporation,* 269 U. S. 504, holding that Section 3466 applied to a debt arising from a contract between the corporation and the Government whereby the former agreed to manufacture and sell

picric acid to the Government. The record (p. 10) before this Court in that case shows that the acid covered by the contract was for the use of the War Department during the World War. If that transaction was not commercial in character, then the transactions here are not, for, in both instances they took place because the Government had engaged in war.

II

THE CLAIMS OF THE UNITED STATES SHOULD HAVE PRIORITY OVER THE CLAIMS OF THE MORTGAGE TRUSTEES.

The language of Section 3466 makes no exception in favor of claims arising under mortgages, and this Court in cases quoted or referred to above has said that the priority of the United States "is over all other creditors."

The Circuit Court of Appeals cites several old cases in this Court and in the lower Federal courts as authority for its holding that the priority claim of the Government is inferior to the mortgage lien. (R. 114.) That court then goes on to say (R. 114):

> * * * The contention of the Government is that the doctrine announced by the decisions just cited, upon which appellees rely, was dictum merely, and, therefore, not entitled to weight as a determination by the Supreme Court; * * *.
>
> With respect to the first of these propositions it may be said that while, strictly speaking, the rule announced by the Su-

preme Court in a number of these cases may be regarded as dictum, nevertheless the reannouncement of the doctrine repeatedly over a period of more than a hundred years serves to establish it, not only as the consistent view of the court, but also as a rule of property upon which practical transactions have been, and are being, based.

The language in all of the cases relied upon apparently springs from the case of *United States* v. *Hooe,* 3 Cranch 73. But that case, we submit, does not *hold* that a mortgagee's rights defeat the priority of the United States. There the United States sued to set aside a deed of trust on the ground that it was fraudulent as to creditors generally and also on the ground that the United States had the right to priority in payment of its debts before the claims secured by the deed of trust could be satisfied out of the proceeds of the mortgaged property. At page 75 it appears that *the evidence did not establish Fitzgerald's* [*the debtor's*] *insolvency,* and this fact is clearly relied upon by the Court on page 90 of its decision. Before the priority granted by Section 3466 can attach, insolvency, manifested in one of the modes described in the statute, must be proved. At page 91, the Court explained that the priority statute applied only where a conveyance or assignment of the debtor's property included *all* his property, and it appeared clearly on page 89 that the deed of trust covered only a *part* of Fitzgerald's property. The priority of the United States did not prevail in that case because the facts before the

Court did not constitute a case within the letter or the intention of the priority statute. The decision would have been exactly the same had Hooe been a mere general creditor. We consequently submit that it is not authority for the proposition that claims of the United States have priority over debts secured by mortgage, although we realize that it has often been so regarded.

We contend that there is no practical necessity (such as the court below urges) for its construction of the priority statute. It can hardly be said that the parties involved in this case contemplated that such debts as the Government is here trying to collect should not be given priority over the mortgage claim. The fact, of course, is that when the mortgages were executed no one ever considered the possibility that the loans in question would be made. They were incidental to the unprecedented emergency caused by the war. If the Government had not taken the action which it did, it is highly likely that the assets of the railroad on which the mortgages give liens would have deteriorated tremendously in value. The action of the Government was undoubtedly exceedingly beneficial to the bondholders.

III

THE CLAIMS OF THE UNITED STATES SHOULD HAVE PRIORITY OVER THE CLAIMS OF PREFERRED CREDITORS

The courts below held that there are certain other preferred creditors. These are creditors whose claims arose as a current expense of ordinary oper-

ation of the railroad, which were necessary for the preservation of the road and to the business of the road, which were contracted with the expectation and intention of the parties that they were to be paid out of the current earnings of the road, and which accrued within six months prior to the appointment of the receiver. (R. 110.) It is, of course, settled that under certain circumstances such creditors have equitable liens upon certain assets of the estate. None of the cases cited in the opinion of the Circuit Court of Appeals (R. 117), however, raises or discusses the relative priority of such claims and claims of the United States, and we are not aware of any case in which this question has been raised.

The argument which we advance above in favor of priority of the claims of the United States over the claims of the mortgage trustees is equally applicable to these preferred claims.

IV

THE CLAIMS OF THE UNITED STATES SHOULD HAVE PRIORITY OVER THE CLAIMS OF GENERAL CREDITORS

The District Court allowed none of the claims of the United States a preferential status even as to general creditors. The Circuit Court of Appeals said (R. 118):

> Inasmuch as only holders of liens legal and equitable are before us on this appeal, and since it is conceded that the estate will not realize more than enough to discharge the mortgage indebtedness and preferred claims, we find it unnecessary to consider the

> effect of the decretal order upon general creditors. It follows from what has been said that the decree should be and is affirmed.

The Master said (R. 74):

> It is improbable that the property of the Minneapolis & St. Louis will sell at foreclosure sale for more than the amount of the mortgaged indebtedness with accrued interest.

The Government, however, has not conceded and does not concede that the estate will not realize more than enough to discharge the mortgage indebtedness and preferred claims. The property has not been sold, and in this situation the Government is not willing that the provisions of the decrees below shall stand. The Government asserted its claim to priority over all other creditors both in the District Court and in the Circuit Court of Appeals. (R. 88–89.) The denial of the Government's claim to priority over general unsecured creditors is contrary to the decisions of this Court in the recent cases of *Bramwell* v. *U. S. Fidelity Co.*, 269 U. S. 483, *supra*, and *United States* v. *Butterworth-Judson Corporation*, 269 U. S. 504, *supra*, unless the court below was right in construing the Transportation Act of 1920 as excluding claims arising under it from the operation of R. S. Section 3466.

CONCLUSION

Application of the priority statute in any case works a certain hardship upon private creditors. General principles of justice and equity obviously

can not control in construing and applying it, unless it is to be annulled by construction. Its harshness is not a matter for the courts, *St. Louis, I. M. & S. Ry. Co.* v. *Taylor,* 210 U. S. 281, 295, but is one of legislative policy, which was settled with the enactment of Section 3466.

The application of the priority statute to the claims of the United States in the instant case, however, can not be said to work a hardship upon the various classes of creditors, inasmuch as the loans and advances of the Government were of great benefit to the mortgage creditors, as has been pointed out above, and it is not reasonable to assume that any class of creditors contemplated that their claims would be preferred to such claims of the Government.

In view of the importance of the questions involved and of the fact that the decision below seems to be in conflict with the principles announced by this Court in the cases which have been cited, it is respectfully submitted that a writ of certiorari should be issued.

CHARLES E. HUGHES, JR.,
Solicitor General.

JOHN LORD O'BRIAN,
The Assistant to the Attorney General.

CLAUDE R. BRANCH,
ELMER B. COLLINS,
Special Assistants to the Attorney General.

SEPTEMBER, 1929.

U. S. GOVERNMENT PRINTING OFFICE: 1929